

Generally, sales of "canned" computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

September 15, 2003

Dear Xxxxx:

This letter is in response to your letter dated June 5, 2003. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's website at [www.revenue.state.il.us/Laws/regs/part1200/](http://www.revenue.state.il.us/Laws/regs/part1200/).

In your letter, you have stated and made inquiry as follows:

This is a request for a General Information Letter pursuant to 2 Ill. Adm. Code 1200.120. We understand this is designed to provide general information and is not a statement of Department policy and is not binding on the Department.

We respectfully request a taxability determination with regard to the issues presented below.

ABC Company is in the business of developing and licensing software to customers, including certain customers in Illinois. The software is licensed in two general categories--capacity based licenses, which provide for upgrade fees when a customer increases system capacity, and non-capacity-based licenses, which are licensed per CPU and therefore are not subject to additional license fees in the event of a CPU capacity increase. It should be noted that capacity increase fees are charged independently of the fees for software updates.

As part of the standard form license, ABC Company offers maintenance service (please see attached contract). This service includes telephonic consulting services and the right to receive new releases, updates and patches for previously licensed products. Fees for this service are charged separately from the license fee. Generally, the maintenance service is provided free of additional cost for the first year of the license agreement, and thereafter the customer pays a fee of either 15 or 18% of the then-current license fee for licensed product.

ABC's software is not a taxable retail sale in Illinois because the licensing agreement (See attached) at issue fulfills the requirements set forth in 86 Ill. Adm. Code 130.1935(a)(1):

1. It is evidenced by a written agreement signed by the licensor and the customer;
2. It restricts the customer's duplication and use of the software;
3. It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
4. The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties or perjury by the licensor; and
5. The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

The question presented is whether the 'maintenance services' which are expressly provided within the licensing agreement and include the right to receive software updates, are taxable under Illinois law.

ABC contends that the maintenance service, like license fees and upgrade charges, is also exempt from taxation. Illinois Regulations provide that 'charges for training, telephone assistance, installation and consultation are exempt if they are separately stated from the selling price of canned software.' 86 Ill. Adm. Code Section 130.1935(b). That Section further provides that 'sellers of maintenance agreements must pay tax on their cost price of the materials transferred incident to the completion of a maintenance agreement.'

ABC avers that since the license is exempt from taxation under the 5 prong test above, any upgrade fees, updates or changes to the software, covered by the same license would similarly be exempt. Additionally, charges for the maintenance agreement, which are separately stated in the contract and separately billed, are also exempt. ABC currently pays tax on the nominal materials which are transferred in the performance of the maintenance service.

If you have any questions or need further information, please call me. Thank you for your attention to this matter.

Generally, sales of "canned" computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See 86 Ill. Adm. Code 130.1935.

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

In the context of a General Information Letter, the Department cannot give you a ruling as to whether the agreement you attached to your letter meets the requirements of Section 130.1935.

In general, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. The taxability of maintenance agreements is dependent upon whether the charge for the agreement is included in the selling price of tangible personal property. If the charge for a maintenance agreement is included in the selling price of tangible personal property, that charge is part of the gross receipts of the retail transaction and is subject to Retailers' Occupation Tax liability. No tax is incurred on the maintenance services or parts when the repair or servicing is completed.

If maintenance agreements are sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the maintenance agreement, the company providing the maintenance or repair will be acting as a service provider under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when a service provider enters into an agreement to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, the service provider incurs Use Tax based upon its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3), enclosed.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software.

Assuming that the services provided, such as installation, phone support, training, and seminars, do not require the transfer of tangible personal property to the recipients of those services, charges for such services are exempt if they are separately stated from the selling price of canned software. See Section 130.1935(b). If computer software training or other support services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for that training are not subject to tax.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis  
Associate Counsel

MAJ:msk  
Enc.